Coca-Cola Amatil 11/07/2017 **FAT-AUS-830**

CCL AUD $8.67 Core **MED.** S

Bubble trouble

It is one thing to expect pricing pressure across Coca-Cola Amatil's (ASX, CCL) less well branded products such as bottled water, but another thing entirely to see further price or volume erosion across products where branding is a lot stronger, such as Coca-Cola. While it is still early days for Coca-Cola Amatil's Coca-Cola No Sugar launch, recent supply-related setbacks with Woolworths and Domino's Pizza highlight the challenges that the company is continuing to face despite their strategic initiatives.

What's new?

Having taken a glass half full approach to Coca-Cola Amatil's recent earnings downgrade, which we discussed in FAT-AUS-819, the latest news flow from the company has effectively become the straw that broke the camel's back. This latest news comes in the form of Woolworth's decision to not stock Coca-Cola Amatil's new Coca-Cola No Sugar drink and Domino's Pizza's decision to not renew their product supply arrangement with Coca-Cola Amatil.

While management was quick to confirm that neither of these recent developments "are material to the performance of the Coca-Cola Amatil Group", it does in our view remind us of the extent of the challenges that the company is facing to reposition its business. As we noted in our last report on Coca-Cola Amatil, while management has outlined a credible business plan to mitigate its key earnings headwinds, it remains uncertain how effective these changes will be.

Unfortunately for Coca-Cola Amatil, the problem is two-fold, with the growing consumer trend towards healthier alternatives to soft drinks having moved the focus to product lines that the company does not have as strong a competitive position. While the launch of Coca-Cola No Sugar is in direct response to this challenge, it is too early to determine whether it will be as successful as Coke Zero.

The fact that Coca-Cola Amatil's research suggests that Coca-Cola No Sugar is preferred by Coca-Cola Classic drinkers to Coke Zero and equally liked by Coke Zero drinkers does not guarantee that it will enable the company to reclaim some of the market share that it has lost to healthier alternatives. While Coca-Cola No Sugar is currently being stocked by Coles, IGA, convenience stores, quick service restaurants and food outlets, Woolworth's decision to opt out is a big negative in our view.

This in our view is likely to reflect the fact that soft drinks, regardless of how much sugar they have, can no longer justify the same level of shelf space that they have in the past. This is evidenced by the growing list of drinks that Coca-Cola Amatil has within its own portfolio. The reality is that the market is becoming more fragmented, particularly when supermarket home brands are added to the mix.

While one swallow does not make a summer, the recent decision by Domino's Pizza to not renew their product supply arrangement with Coca-Cola Amatil is in our view is also symptomatic of the same problem. That is, the increasingly fragmented drinks market is resulting in higher levels of competition across more traditional product lines such as soft drink. It seems reasonable in our view to assume that Domino's Pizza's recent decision was based almost entirely on price.

Key takeaways

It is one thing to expect pricing pressure across Coca-Cola Amatil's less well branded products such as bottled water, but another thing entirely to see further price or volume erosion across products where branding is a lot stronger, such as Coca-Cola. While it is still early days for Coca-Cola Amatil's Coca-Cola No Sugar launch, recent supply-related setbacks with Woolworths and Domino's Pizza highlight the challenges that the company is continuing to face despite their strategic initiatives.

Turning to the charts, and on the daily, prices are trading below both the 50 (red line) and 200 (green line) day moving averages, which is suggestive of medium-term momentum to favour the downside. Moving forward, it is important that prices consolidate above support sighted at the 78.6% Fibonacci retracement of $8.54. Should this occur, then this would likely encourage a period of price stabilisation to unfold over the broader horizon. However, if the bears were to remain in control over the near term , then an eventual test of key support located at the $7.90 mark could become reality.

In terms of Coca-Cola Amatil's monthly technical chart, support was respected at the 78.6% Fibonacci retracement (blue set of retracements) of $7.91 in February 2016 which is a positive event. In-turn, a solid upward trajectory in share price has since followed. However, our previously defined band of resistance located between $10.77 (38.2% Fibonacci retracement – red set of retracements) and $11.00 (April 2015 high as illustrated by the horizontal solid-red line) has halted the recent advance. For this reason, momentum has once again turned south.

Summary

We remain of the view that management's previously announced strategic initiatives will ultimately bolster Coca-Cola Amatil's position in its core market. However, as evidenced by Coca-Cola Amatil's recent supply-related setbacks with Woolworths and Domino's Pizza, it now appears as the road ahead will be a lot bumpier than we had initially thought. While management appear unfazed by these recent developments, we have now opted to watch how this unravels from the sideline.

Consequently, we now recommend that Members sell their holding in Coca-Cola Amatil.

Coca-Cola Amatil is held in Fat Prophets Income Model.

Snapshot CCL

Coca-Cola Amatil

Latest Closing Price: $8.67

Coca-Cola Amatil Limited manufactures, distributes and markets carbonated soft drinks, still and mineral waters, fruit juices, coffee and other alcohol-free beverages. The Company is also engaged in the processing and marketing of fruit, vegetables and other food products. CCA’s principal operations are in Australia, New Zealand, Fiji, Indonesia and Papua New Guinea (PNG). The company has a 10 year agreement with Beam Global for the manufacture, sales and distribution of the premium spirits portfolio in Australia.

Market Capitalisation:$6.6B

	FY1	FY2
Price to Earnings	15.8	15.1
Dividend Yield (%)	5.3	5.4
Price to Book	3.44	3.39
Return on Equity (%)	21.0	22.1
EV/EBITDA	8.4	8.0